

## Stephenson, April, Ms, SES DCAA

---

**From:** Stephenson, April, Ms, SES DCAA  
**Sent:** Sunday, September 13, 2009 5:53 PM  
**To:** shay.assad@osd.mil  
**Cc:** 'Ginman, Richard, Mr, OSD-ATL'; Saccoccia, Kenneth, Mr, SES DCAA; Summers, Frank, Mr, SES DCAA; Johnson, David, Mr, DCAA  
**Subject:** DCAA LEG Proposals for FY 2011  
**Attachments:** DCAA LEG Proposals for 2011.pdf



DCAA LEG  
oposals for 2011.pdf

Shay -

Attached are two legislative proposals submitted by DCAA.

The first addresses increased subpoena authority as mentioned during the DCAA Oversight Committee meeting a few weeks ago.

The second addresses applying the executive compensation cap to more than just the top 5 executives.

Please contact me if you have any questions.

April



**DEFENSE CONTRACT AUDIT AGENCY  
DEPARTMENT OF DEFENSE  
8725 JOHN J. KINGMAN ROAD, SUITE 2135  
FORT BELVOIR, VA 22060-6219**

OFFICE OF THE DIRECTOR

September 11, 2009

**MEMORANDUM FOR DOD GENERAL COUNSEL, OFFICE OF LEGISLATIVE  
COUNSEL**

**SUBJECT: Call for Legislative Proposals for FY 2011**

In response to your memorandum dated July 31, 2009, same subject as above, DCAA submits two legislative proposals for inclusion in the DoD FY 2011 National Defense Authorization Act. In order of preference, we submit the following legislative proposals:

- Amend Section 2313 of Title 10 to expand DCAA's access to contractor records required to accomplish our mission as a remedy to a prior court imposed limitation (Enclosure 1).
- Amend Section 256 of Title 41 and Section 2324 of Title 10 to expand the application of the limitation on allowable compensation from the top five executives to all contractor employees (Enclosure 2).

I certify that these proposals have been reviewed by DCAA General Counsel and cleared by me. Any questions regarding the DCAA legislative proposals may be directed to Mr. Kenneth Saccoccia at (703) 767-3280.

  
April G. Stephenson  
Director

Enclosures: a/s

Legislative Proposal to Revise  
SEC. 2313 of Title 10 Examination of records of contractor

**Expand Access to Contractor Records and DCAA Subpoena Authority**

**Section-by-Section Analysis**

This proposal would amend subsection (a) of section 2313 of Title 10 to expand DCAA's access to contractor records as the authorized representative of the head of an executive agency (i.e., Secretary of Defense) by granting DCAA access to records the Agency needs to accomplish its mission. This proposal would also specifically provide access to contractor management reviews and internal audits related to Government contract costs or internal control over compliance with Government regulations. In addition, because the subpoena authority provided in subsection (b) of section 2313 of Title 10 is based on the access under subsection (a) of section 2313, this amendment would also expand DCAA's subpoena authority to include those records. The proposal also includes a minor clarification to subsection (b)(1) of section 2313 of Title 10 by adding "or subcontractor" after the phrase "of any records of a contractor" to make subsection (b) consistent with subsection (a).

DCAA is required to perform audits in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require DCAA to obtain sufficient evidence to provide a reasonable basis for the conclusions expressed in its audit reports. Because the courts have limited DCAA's access to contractor records under the existing laws, the proposed amendments are needed to provide DCAA with the access required to obtain sufficient evidence to comply with the applicable auditing standards.

Although Congress gave the Director of DCAA the authority under Public Law 99-145, 10 U.S.C. 2313(b), to issue subpoenas when a contractor refuses to grant DCAA access to the records covered by 10 U.S.C. 2313(a)(1) and (a)(2), the United States Court of Appeals, Fourth Circuit – 837 F. 2d 162, denied enforcement of a DCAA subpoena related to internal audit material from Newport News Shipbuilding. The Court interpreted 10 U.S.C. 2313(b) to mean data subject to a DCAA subpoena should be related to negotiations, pricing, or performance of a particular contract. In this particular instance, the Court ruled that management reviews and internal audits were determined to be beyond the statutory provisions of DCAA subpoena power.

Government contractors frequently use the Newport News court case as a basis for denying DCAA access to records that DCAA requires to carry out the Agency's contract audit function. The proposed amendments to 10 U.S.C. 2313 would give DCAA access to the types of records needed to accomplish the Agency's mission and would specifically provide DCAA the statutory authority to access management reviews and internal audits related to Government contract costs and the contractor's internal control over compliance with applicable Government regulations.

DOD Directive 5105.36, Defense Contract Audit Agency (DCAA), states the DCAA mission is to "perform all necessary contract audits for the Department of Defense and provide

accounting and financial advisory services regarding contracts and subcontracts to all DoD components responsible for procurement and contract administration. These services will be provided in connection with negotiation, administration, and settlement of contracts and subcontracts.” As a part of that mission, DCAA audits costs proposed and incurred on Government contracts. DCAA audits contractor accounting systems before and after contract award to assess whether the systems are adequate for accumulating and billing costs compliant with contract requirements. In addition, for major contractors, DCAA audits contractor internal control systems as a basis for relying on those systems during other DCAA audits, e.g., audits of proposed or incurred costs. It is essential for DCAA to have access to contractor management reviews and internal audits in order to evaluate contractor internal control systems.

Additionally, the Federal Acquisition Regulation was recently revised to address contractor codes of business ethics and to require contractors to disclose to the Government violations of criminal laws, violations of the Civil False Claims Act, and significant overpayments while also adding consequences when a contractor fails to disclose. The applicable contract clause also requires the contractor to establish an internal control system that facilitates timely discovery of and corrective action related to improper conduct, including periodic reviews, such as monitoring and auditing to detect criminal conduct. DCAA audits of contractor internal controls include procedures for testing contractor compliance with these new requirements. The referenced Newport News decision brings into question the DCAA statutory authority to require contractors to provide internal documents supporting the reliability of the related internal control systems.

DCAA needs access to the contractors’ internal documents to determine that contractors are taking appropriate corrective action when irregularities or misappropriations are identified, that the Government is not overcharged, and that appropriate contractor disclosure has been provided to Government officials in compliance with the recently revised requirements.

**Budget Implications:** The proposal has no budgetary impact as it addresses procurement processes and not amounts appropriated for procurement of items or services.

**Unified Legislative Budget (ULB) Proposal Number:** N/A

**Department of Defense Priority: Preserve and Enhance the Force by Improving Government Acquisition** -- Expanding DCAA access to contractor records and specifically including management reviews and internal audits related to Government contract costs or internal control over compliance with Government regulations will give DCAA access the contractor records needed to carry out the Agency’s contract audit function. This change would also enhance DCAA’s ability to perform audits, in accordance with GAGAS, necessary to verify contractor compliance with contractual requirements. Efficient and effective performance of these audits may lead to improved contractor compliance levels and more practical and efficient procurement processes and programs that are also in line with the President’s agenda to improve Government acquisitions while ensuring best value for the taxpayer.

**Reviewing Legal Counsel:** John Farenish (703), 703-767-3219, john.farenish@dcaa.mil

**Agency Subject Matter Expert:** Kenneth J. Saccoccia, Assistant Director, Policy and Plans Directorate, Defense Contract Audit Agency, 703-767-3280, DCAA-P@dcaa.mil

**Changes to Existing Law:** This proposal would amend section 2313 of 10 U.S.C. by revising subsections (a) and (b) as noted below with added text represented in **bold underline** with eliminated text ~~struck through~~:

Title 10 U.S.C.

§2313. Examination of records of contractor

**a) Agency Authority.—**

(1) The head of an agency, acting through an authorized representative, is authorized to inspect the plant, ~~and audit, and have access to the~~ **all records, audits, reviews, documents, papers, recommendations, or other material (including management reviews and internal audits related to government contract costs or internal control over compliance with government regulations)** available to the applicable contractor or subcontractor **which relate to the authorized representative's performance of all necessary contract audits and accounting and financial advisory services in connection with the negotiation, administration and settlement of contracts and subcontracts of—**

(A) a contractor performing a cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable contract, or any combination of such contracts, made by that agency under this chapter; and

(B) a subcontractor performing any cost-reimbursement, incentive, time-and-materials, labor-hour, or price-redeterminable subcontract or any combination of such subcontracts under a contract referred to in subparagraph (A).

(2) The head of an agency, acting through an authorized representative, is authorized, for the purpose of evaluating the accuracy, completeness, and currency of certified cost or pricing data required to be submitted pursuant to section 2306a of this title **or for the purpose of evaluating information other than certified cost or pricing data** with respect to a contract or subcontract to **have access to and** examine all records, **audits, reviews, documents, papers, recommendations, or other material (including management reviews and internal audits related to government contract costs or internal control over compliance with government regulations)** available to ~~of the~~ **applicable** contractor or subcontractor related to—

(A) the proposal for the contract or subcontract;

(B) the discussions conducted on the proposal;

(C) pricing of the contract or subcontract; or

(D) performance of the contract or subcontract.

**(b) DCAA Subpoena Authority.—**

(1) The Director of the Defense Contract Audit Agency (or any successor agency) may require by subpoena the production of any records of a contractor **or subcontractor** that the Secretary of Defense is authorized to audit or examine under subsection (a).

(2) Any such subpoena, in the case of contumacy or refusal to obey, shall be enforceable by order of an appropriate United States district court.

(3) The authority provided by paragraph (1) may not be redelegated.

**Permanent Extension of Applicability of the Senior Executive Benchmark  
Compensation Amount (Allowable Cost Limitation)  
to all Contractor Employees**

**Section 256 of title 41, along with 2324 of title 10, United States Code, is amended by deleting and adding text shown in the "Changes to Existing Law" section below.**

**Section-by-Section Analysis**

This proposal would amend 41 U.S.C. 256(e)(1)(P) and 41 U.S.C. 256(m), along with 10 U.S.C. 2324(e)(1)(P) and 10 U.S.C. 2324(l), which would collectively expand the existing executive compensation cap so that it would apply to all employees of a contractor instead of just the "five most highly compensated" management employees of each contractor's segment or home office. Changes are required to title 41, *Public Contracts*, and title 10, *Armed Forces*, as the language is identical. We are not recommending any changes in the way that the compensation cap is calculated in accordance with 41 U.S.C. 435.

In accordance with 41 U.S.C. 256(e)(1)(P) and 10 U.S.C. 2324(e)(1)(P), the allowable costs of compensation of senior executives of contractors is limited to the benchmark compensation amount set by the Administrator of the Office of Federal Procurement Policy under section 39 of the Office of the Federal Procurement Policy Act (41 U.S.C. 435). In accordance with 41 U.S.C. 435, the Administrator [of the Office of Federal Procurement Policy] shall review commercially available surveys of executive compensation and, on the basis of the results of the review, determine a benchmark compensation amount to apply for each fiscal year. The benchmark compensation amount (commonly referred to as the "compensation cap") applicable for a fiscal year is the median amount of the compensation provided for the five most highly compensated employees in management positions at each home office and each segment of the contractor (i.e., senior executives) of all benchmark corporations for the most recent year for which data is available. The term "benchmark corporation" means a publicly-owned United States corporation that has annual sales in excess of \$50,000,000 for the fiscal year. Collectively, these sections limit the allowable cost of compensation of the five most highly compensated employees in management positions at each home office and each segment of the contractor to the benchmark compensation amount.

In the mid-nineties, there was increasing concern in Congress regarding seemingly excessive individual compensation charged to DoD contracts. As a result, for FY 1995 and FY 1996, Congress limited the allowability of individual compensation [of all employees] on covered DoD contracts. For 1997 through 2009, Congress revised the application of the compensation ceiling so that it applied only to certain contractor personnel generally identified as the top five most highly compensated individuals in senior management positions at each home office and each segment of a contractor. We believe that the current law which limits the compensation of only the five most highly compensated employees in management positions places the Government at an unacceptable risk of reimbursing contractors for excessive compensation costs.

The intent of the compensation cap is to reduce the risk of excessive individual compensation charged to Government contracts. Our audits have shown that there are lower level executives not subject to the cap and non-executive employees who receive compensation in excess of the benchmark compensation amount. In addition, if a contractor is not organized into multiple segments only the top five executives are covered by the benchmark compensation amount whereas similarly sized contractors with multiple segments will have additional employees subject to the cap. Limiting the application of the compensation cap to only the top five executives places the Government at risk of reimbursing contractors for excessive compensation. Therefore, as a matter of public policy, we recommend the amendments to 41 U.S.C. 256(e)(1)(P) and 41 U.S.C. 256(m), along with 10 U.S.C 2324(e)(1)(P) and 10 U.S.C. 2324(l), to place limits on all contractor employee compensation as shown in the "Changes to Existing Law" section below.

**Budget Implications:** This proposal has no budgetary impact. It only proposes to expand the applicability of the executive benchmark compensation amount allowable cost limitation to all contractor employees.

**Unified Legislative Budget (ULB) Proposal Number:** N/A

**Department of Defense Priority: Preserve and Enhance the Force by Improving Government Acquisitions** – This proposal supports the Administration's current direction to eliminate the Government's reimbursement of excessive compensation as intended by the compensation cap. As such, the compensation cap should not be limited in its applicability to only a select few individuals in the company. The compensation cap helps to ensure that the taxpayer receives best value for the acquisition dollars spent.

**Resubmission Justification:** This proposal is being submitted for the first time.

**Reviewing Legal Counsel:** John Farenish, (703), 703-767-3219, john.farenish@dcaa.mil

**Agency Subject Matter Expert:** Kenneth J. Saccoccia, Assistant Director, Policy and Plans Directorate, Defense Contract Audit Agency, 703-767-3280, DCAA-P@dcaa.mil

**Changes to Existing Law:** This proposal would amend 41 U.S.C. 256(e)(1)(P) and 41 U.S.C.256(m), along with 10 U.S.C. 2324(e)(1)(P) and 2324(l), This proposal would amend; Section 256(e) of Title 41 and Section 2324(e) of title 10, United States Code, by deleting and adding text in Section 256(e)(1)(P) and 256(m) of Title 41 while also deleting and adding text in 2324(e)(1)(P), and Section 2324(l) of title 10, United States Code. Added text is represented by **bold underline** with eliminated text ~~struck through~~:

## **Title 41 Chapter 4 Subchapter IV**

### **§256. Allowable costs**

\* \* \* \* \*

#### **(e) Specific costs not allowable**

(1) The following costs are not allowable under a covered contract:

\* \* \* \* \*

(P) Costs of compensation of employees ~~senior executives~~ of contractors for a fiscal year, regardless of the contract funding source, to the extent that such compensation exceeds the benchmark compensation amount determined applicable for the fiscal year by the Administrator for Federal Procurement Policy under section 435 of this title.

\* \* \* \* \*

#### **(m) Other definitions**

In this section:

(1) The term "compensation", for a fiscal year, means the total amount of wages, salary, bonuses and deferred compensation for the fiscal year, whether paid, earned, or otherwise accruing, as recorded in an employer's cost accounting records for the fiscal year.

~~(2) The term "senior executives", with respect to a contractor, means the five most highly compensated employees in management positions at each home office and each segment of the contractor.~~

(23) The term "fiscal year" means a fiscal year established by a contractor for accounting purposes.

## **Title 10 Subtitle A Part IV Chapter 137**

### **§2324. Allowable costs under defense contracts**

\* \* \* \* \*

#### **(e) Specific Costs Not Allowable,**

(1) The following costs are not allowable under a covered contract:



\* \* \* \* \*

(P) Costs of compensation of ~~senior executives~~ employees of contractors for a fiscal year, regardless of the contract funding source, to the extent that such compensation exceeds the benchmark compensation amount determined applicable for the fiscal year by the Administrator for Federal Procurement Policy under section 39 of the Office of Federal Procurement Policy Act (41 U.S.C. 435).

\* \* \* \* \*

(I) Definitions. - In this section:

(1)(A) The term "covered contract" means a contract for an amount in excess of \$500,000 that is entered into by the head of an agency, except that such term does not include a fixed-price contract without cost incentives or any firm fixed-price contract for the purchase of commercial items.

(B) Effective on October 1 of each year that is divisible by five, the amount set forth in subparagraph (A) shall be adjusted to the equivalent amount in constant fiscal year 1994 dollars. An amount, as so adjusted, that is not evenly divisible by \$50,000 shall be rounded to the nearest multiple of \$50,000. In the case of an amount that is evenly divisible by \$25,000 but is not evenly divisible by \$50,000, the amount shall be rounded to the next higher multiple of \$50,000.

(2) The term "head of the agency" or "agency head" does not include the Secretary of a military department.

(3) The term "agency" means the Department of Defense, the Coast Guard, and the National Aeronautics and Space Administration.

(4) The term "compensation", for a year, means the total amount of wages, salary, bonuses and deferred compensation for the year, whether paid, earned, or otherwise accruing, as recorded in an employer's cost accounting records for the year.

~~(5) The term "senior executives", with respect to a contractor, means the five most highly compensated employees in management positions at each home office and each segment of the contractor.~~

~~(56)~~ The term "fiscal year" means a fiscal year established by a contractor for accounting purposes.